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SUBJECT: Israeli High-Tech Surviving the Global Downturn

REF: Tel Aviv 653

¶1. (SBU) Despite fears that the global economic recession would severely impact Israel's high-technology sector, industry analysts and participants are pleased with the resilience it has shown. Though potentially vulnerable on several fronts, both the production and R&D facets of the sector are surviving and looking forward to an upturn in 2010. Action by the government to increase support for Israeli R&D spending was welcomed by the sector.

¶2. (SBU) The vulnerability of the sector, which accounts for nearly half of Israel's export earnings, stems partly from the country's highly-focused trade. Almost 37 percent of Israel's exports are sent to the United States, and the lion's share of high-tech industrial goods, making the American-based recession daily news in Tel Aviv. The large U.S. companies that buy from Israel (e.g., Apple, Motorola, Microsoft) are down five or six percent in sales, and Israeli exports have shown about the same marginal slowdown. First quarter 2009 technology exports from Israel were down by 6.3 percent from the same 2008 period, \$3.84 billion versus \$4.1 billion. Unemployment in the tech sector in Israel, however, has risen to an estimated 8 percent, implying that job losses have been focused on the labor-intensive R&D side of the sector rather than production. Analysts expect another 10,000 hi-tech workers may yet lose jobs this recession.

¶3. (SBU) Israeli dependence on foreign venture capital is an even more serious vulnerability; with banks globally in low-lending mode and private venture capital firms stunned by market losses, investment angels are hard to find. Nonetheless, the final tally of venture capital raised by Israeli firms in 2008 was USD 2.08 billion, an 18 percent increase over the 1.76 raised in 2007. This may be explained, in part, by Israelis choosing to invest at home, given the poor returns and high risk in major foreign markets. However the chief reason analysts offer is the sector's variety of expertise; Israel's strong presence in the still growing area of heavy bandwidth technology to handle the growing internet traffic in on-line video has kept demand for Israeli innovations growing on the IT side. The country's medical technology sub-sector also expects strong growth; exports of medical technology and pharmaceuticals grew from \$3.64 billion to \$4.97 billion from 2007 to 2008. The greentech/cleantech area is also growing strongly, although some analysts believe it will have less impact than expected, possibly because implementing such technologies will entail large government or corporate investments which are less likely in the recessionary climate. Only in the first quarter of 2009 does the global downturn show its teeth, with a 33 percent drop in capital raised by Israel's technology sector compared to the previous quarter.

¶4. (SBU) One area of vulnerability - progressive reductions in government support of the high-tech sector in general - might be

avoided by timely GOI action. The new Israeli government plans to greatly increase (possibly double) the R&D budget of the Chief Scientist of the Ministry of Trade, Industry and Labor, and to expedite payments due researchers already engaged under the Chief Scientist's program. Previous years have seen this important source of innovation seed capital cut back (reftel), and industry executives welcomed the government's move to reverse this trend. Although this Ministry's support is small in global capital terms, it has proven itself effective in cultivating start-ups that have a commercially viable future. More important to the new government, it holds the prospect of future job creation in a country that is experiencing its highest unemployment in the past five years -- 7.5 percent, expected to rise to 8 percent before year end.

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